

VZCZCXYZ0000
OO RUEHWEB

DE RUEHSG #0489/01 1421818
ZNR UUUUU ZZH
O 221818Z MAY 09
FM AMEMBASSY SANTIAGO
TO RUEHC/SECSTATE WASHDC IMMEDIATE 4974
INFO RUCNMER/MERCOSUR COLLECTIVE
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC
RUEHQT/AMEMBASSY QUITO 2379
RUEKJCS/SECDEF WASHDC
RUEAIIA/CIA WASHDC
RHEHNSC/NSC WASHDC

UNCLAS SANTIAGO 000489

STATE PLEASE PASS TO USTR KATE DUCKWORTH
STATE PLEASE PASS TO FEDERAL RESERVE TOM CONNORS
TREASURY FOR SSENICH
COMMERCE FOR KMANN

SIPDIS

E.O. 12958: N/A
TAGS: [ECON](#) [EFIN](#) [ETRD](#) [EINV](#) [ECIN](#) [PGOV](#) [PREL](#) [CI](#)

SUBJECT: CHILE: CENTRAL BANK CONFIRMS ECONOMY HIT HARDER THAN
PREVIOUSLY PROJECTED

¶1. SUMMARY: Chile's Central Bank announced it had sharply downgraded projections for economic growth in 2009, due to the stronger than expected impact of the international financial crisis. The Central Bank predicts GDP growth in 2009 will be between 0.25% and negative growth of -0.75%. In the first quarter of 2009, GDP contracted (-2.1%), domestic demand fell significantly (-7.6%), and there was a drop in domestic industrial production (-10.3%) compared to the same period the year before. The first quarter also demonstrated evidence of a significant increase in the unemployment rate (9.3%) and a decline in international trade (-13.5%) compared to the first quarter of 2008. Experts are debating whether Chile's economy has hit bottom or the worst is yet to come. END SUMMARY

A Possible Negative Growth Rate In 2009

¶2. The Central Bank on May 14 projected GDP growth for 2009 will be between 0.25% and negative growth of -0.75%. This follows projections made by the Bank in January 2009 of 2-3% GDP growth for the year. In the course of the second half of 2009 and throughout 2010, the Bank sees a return to positive economic growth, in line with the easing in monetary policy, the fiscal stimulus packages recently announced by the GOC, and the solid fundamentals of the Chilean economy. Many analysts in Chile and abroad are predicting that Chile is one of the countries best placed to rebound quickly after the crisis ends.

Crisis Has Hit Chile Harder Than Expected

¶3. The Central Bank's new projections confirm a view widely held by most Chilean economists -- the international financial crisis has hit the domestic economy harder than previously expected. Signs of an increasingly serious slow-down were evident in the fourth quarter of 2008. There was a major reduction in output, especially in domestic demand, a weakening in the labor market, and a reduction in inflation and inflationary projections. Since then the Central Bank has reacted aggressively, cutting the key national interest rate (monetary policy rate) by 700 basis points between January and May ¶2009. Indeed, the Bank has not ruled out the possibility of further reductions in the interest rate (currently at 1.25%).

¶4. The negative effects of fourth quarter 2008 have carried over to the first quarter of 2009. According to the Central Bank, the Chilean economy experienced a strong contraction during the first quarter of 2009 compared to the same quarter the year before. GDP decreased by 2.1%, marked by a strong slowdown in industrial

production (-10.3%), including in the construction sector (-1.3%) and associated services. The drop in growth can be explained mainly by a sharp decline in domestic demand (7.6%) compared to the first quarter in 2008. Gross fixed capital formation dropped by 9.3%, compared to the 10.4% increase registered the previous quarter. These numbers are all at their lowest levels since 1999 when the Asian crisis hit the Chilean economy.

Increasing Unemployment

15. During the first quarter of 2009, the unemployment rate rose to 9.3%. Due to the current decline in national production and domestic demand, most economists in Chile believe labor market conditions will deteriorate further in the months to come. Analysts expect a double digit unemployment rate for 2009. However, measures announced by the GOC as part of the National Agreement for Employment could moderate the expected rise in unemployment.

Inflation Projections Below Target

16. Chile has seen a rapid decline in inflation since the last months of 2008, as a result of the drop in commodity prices, mainly in oil and derivative products. Annualized CPI inflation dropped from its peak of 9.9% in October 2008 to 4.5% in April 2009. The Central Bank's projections assume that year-to-year inflation will continue to decline in the coming months below the policy-horizon rate of 3%. In fact, the Bank has postulated that annual CPI could be negative between the third and the fourth quarters of this year, to close 2009 at an annual rate of 0.6%.

Trade: Surplus After Two Quarters Of Deficit

17. Chile's trade with international partners fell significantly between May 2008 and May 2009, eroding national disposable income (-2.8%). The Central Bank reported a current account surplus of US\$639 million (equivalent to 1.8% of GDP) in the first quarter of 2009. This marks a drop of US\$820 million compared to the first

quarter of 2008. However, it is an improvement compared to the current account deficits of US\$2.9 billion and US\$2.7 billion registered during the third and fourth quarters of 2008, respectively.

18. According to the General Directorate of International Economic Relations (DIRECON, the equivalent of USTR), Chile's trade surplus recorded a drop of 68.5% in the first quarter of 2009, compared to the same period in 2008 (totaling US\$1.96 billion). Also during the first quarter, exports fell by 42.8% (totaling US\$11 billion). Copper prices (Chile's leading export sector) fell by 56% in the same period, averaging US\$1.6 per pound. The amount of copper exported during the first quarter of 2009 reached US\$4.2 billion -- a drop of 61% compared to the same period the year before. Imports in general fell by 31% in the first quarter of 2009. In particular, there were significant decreases in imports from the U.S. (-30.8%), MERCOSUR countries (-22.2%), and China (-16.3%).

Comment

19. Chile's analysts and economists are debating whether the domestic economy has already bottomed out and will now begin recovery, or if the worst is still to come. The Central Bank seems more optimistic and expects improved figures in the second quarter of 2009. However, noted economist and former Central Bank President, Vittorio Corbo, believes there is no evidence that the economy has hit its lowest level yet. He admits there are signs that the velocity of its fall has moderated. It appears the Central Bank is betting the current recession will be a short one based on the premise that the GOC's fiscal stimulus packages will be enough to prop up certain components of the economy in the face of the crisis, especially private consumption.

SIMONS